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Intangible Capital and Leverage to Improve Financial Performance of LPG Agents in Bali

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Abstract

The role of government is needed to solve the financial difficulties through the provision of credit with low interest rates. However, not all companies take advantage of this facility. Therefore, another way is needed to encourage small and medium companies improve their performance. The research aims to reveal small and medium business in a different perspective such as generally observing intangible capital, e.g. social and local culture capital. The result shows that social and local culture capitals owned by the business are able to improve capital growth as well as financial performance.

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Keywords: intangible capital; debt; financial performance

1. Introduction

Most of Small and Medium Enterprise (SME) in Indonesia are having financial problem to improve performance. This problem caused slow business growth (Beck and Dermirguc-. Kunt, 2006). Therefore, particular ways are needed to solve this problem, such as governmental aid(Tae and So, 2005).However, if governmental aid is insufficient to be used as a financial source, another financial sources are needed, such as utilizing human ability to access external equity (Beck and Dermirguc-Kunt, (2006), Ayyagari*et al*. (2010), Allen, *et al*. (2012)). Previous research, such as

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Carton and Hofer (2006), Vos*et al*. (2007), Bates (1997), Koszan *et al*. (2011)are not able to providetotal solution on financial problem with various limitations faced by small and medium business. Therefore, this research aims to test intangible capital and financing decision (debt and equity) in improving financial performance, as well as including local culture as intangible capital indicator besides social capital. Local culture used here is the result of cultural development by Hofstade (1998) that stated that there are three important components in explaining the cultural power of a company: behavior, value, and organizational culture. Culture, as suggested by Brooks (2008), has to be exists as a function of cognitive tools that shows that those cultural elements have values, behaviors, trust or, sometimes, a norm. Cultures that are regarded as necessary to be included as intangible capital are exogenous variable element as well as the relationship between intangible capitals (social and local culture capitals) that influences internal and external financing to improve company's financial performance. The difference between this research and previous researches is the existence of social capital variable reflected from norm-valued behavior, social network, trust, as well as high expectation valued from continuous activity especially those related to financing source. Local culture as a form of local genius becomes a control variable both directly and indirectly through company financing sources that are able to influence company performance. This research has a contribution to the balancing theory of Myer (1984)as well as agency theory (Jensen and Meckling (1976)) related to the financing sources utilizing social and local culture capitals to improve company performance.

Colombo and Grilli (2005), suggested that external equity financing has an important role in solving the imperfection of financing source, as well as external financing cost that is higher than internal financing opportunity cost (personal capital, including entrepreneur, family members, as well as friend's savings).Denis (2004)finds that the difficulty of realizing external financing for entrepreneurs is related to two fundamental problems. Those are: information asymmetry, as well as moral hazard. While entrepreneur understands the quality of proposed business, it can be difficult for the investor to understand. Another alternative is that external investor and entrepreneur probably disagree with the project price and its success probability. Moral hazard acknowledges that when there is a substantial external financing, the entrepreneur may misuse or misallocate the fund for his/her personal advantage. The result of research conducted by Nofsinger and Weicheng (2011) shows that investor protection has a positive and significant effect on external financing access, disregarding the type of the investor. Evidence also shows that informal investors are prefer to invest their fund to new business regarding the new products released.

Allen and Qian(2010) stated that alternative financing supported by its financing mechanism may be more advantageous than banks and financial market supported by legal institution. Allen *et al*. (2012)suggested that alternative financing is non-internal financing for all non-bank, non-market sources, forming the most important external financing operating generally outside formal institution. This form of financing is supported by financing mechanism such as company goodwill (reputation), relationship, and trust. Good reputation supported by norm values that are applied generally and convinced as true, as well as the existence of a relationship reflected by strong network and the bond of trust is a reflection of a high intangible capital. Good company reputation, harmonious relationship as well as high trust can be regarded as indicators of social capital (intangible capital) that have to be maintained. Bank loan also works as the most important form of external financing, whereas financial market has limited role in financing to improve company growth. This alternative financing source is not explicitly related to company's financial performance. However, it is related to the company growth. Company growth realized from increasing sales rate can reflects company performance.

Generally, most of small family-owned business operating in a country or an area is directly involves family members in their management (Wu, Z. *et al*., 2007). Family involvement can improve performance since the forming of performance is multidimensional based (Carton and Hofer, 2006). One of primary performance dimension discussed in that research includes profitability. Financial performance achieved by small and medium companies is related to financing (Vos et al. 2007). Financial performance viewed from ROA growth indicator as well as profit margin. In addition, there is no rational determining factor impedes small and medium business (SME) financing, such as environmental risk and return. Voydanoff (2001), studies a strong network formed from the interaction conducted among individuals can influence internal or external financing to improve company performance. Social network as an indicator of social capital apparently determines financing sources of small and medium companies. The importance of social capital as an intangible capital influencing small and medium business financing is studied by Bates (1997), that is related to the creativity of small business financing in entrepreneurship case. Financing from these small and medium business start-up capital are formulated from financing sourced from the business owner.

Social capital variable is used to explain gained results. While the debt source used are sourced from family, friends, financial institutions, as well as ex-owner. Koszan*et al.* (2011), stated that one key variable to predict the dynamic of small company growth is by using three different items, i.e: *personal, financial, and relation*. The result of research conducted by Koszan*et al.* (2011)shows that company growth achievement is related to cultural characteristic in each particular area. Chua, J. H. *et al.* (2009)and Wu and Wang (2004)suggested that social capital is needed to reduce the apprehensive of the difficulties to obtain financing sourced from financial institutions. Family involvement can directly and indirectly improve access to debt financing. Debt financing is an important capital source. However, it is difficult to be obtained by new business, since agency problems are caused by conflict of interest as well as asymmetric information between debtor and creditor. There are many solutions to this problem for bug and settled companies. However, small companies (Bosse, 2009) must depend on social capital if they are to obtain loan.

Study by Chua, J. H. *et al.* (2011) focused on family as lent social capital sourceand proposed that family involvement straighten family and business interests. Therefore, family involvement shall improve business ability to borrow family's social capital, both directly or indirectly, to solve agency problems with the lender. Tangible and intangible social capital will maintain company competitiveness. Tsamenyi *et al.*(2007) found that ratio between tangible and intangible assets took place in 1929 are 70 and 30 percent respectively. There is a remarkable shift in 2002 to 15 and 85 percent respectively. Regarding how important the intangible assets are in an organization, it is necessary to conduct further research. Therefore, its effects on financing to improve company performance will be discovered Laksono (2009) and Tsamenyi *et al.* (2007) suggested that there are a paradigm shift that shows the importance of intangible assets. This result is supported by Chua, J. H. *et al.* (2009) and Bates (1997) that suggested that social capital plays as intangible capital influencing company financing as well as debt sourced from family, friends, financial institutions, and ex-owner. Study by Mazzi (2011)connected family ownership and financial performance, aimed to reconstruct existing theoretical framework andknowledge system.

2. Research Hypotheses

2.1 Intangible Capital and Internal Financing Decision

Anderson, and Eshima, Y (2011) suggested the importance of intangible assets to encourage excellent SME growth. Nofsinger and Weicheng (2011) stated that investment institutions provide funds or financing by taking into account the company experience in managing start-up capital as well as how is the quality of its investors' protection. Tappeiner *et al.* (2012) stated that non-financial sources provided from personal equity improve personal equity value. A study by Gomez- Mejia *et al.* (2011)emphasized that non-economic factors play important roles in managerial preference. Wood *et al.*(2012) explained that family business sector is strongly characterized with high number of equity and culture providers, as well as systems that support contract establishment. Chua, J. H. *et al.* (2011) explained that social capital can help small companies to obtain financing from financial institution as the fund owner since there is a good social capital. This will reduce the apprehensive on the security of the invested fund. Bosse (2009) stated that small companies must depend on social capital to obtain loans. In this research, the loans can be sourced from owner's family, ex-owners, or shared inheritance that is used to establish family business.**H1: *Intangible Capital* significantly affects the decision on internal financing source to improve company's financial performance.**

2.2 Intangible Capital and External Financing Decision

Bosse (2009) stated that family involvement has to encourage business ability to borrow family's social capital, both directly and indirectly, to solve agency problem with the lender (Jensenand Meckling, 1976). The indirect effect of this is the ability of family involvement to improve the relationship between the company and the lender, as well as to increase the opportunity to obtain a third party security.Nofsingerand Weicheng (2011), and Bates (1997) explained the presence of financing sourced from loan of the studied companies that influence company viability that use those external financing sources.**H2: *Intangible Capital* significantly affects the decision of external financing source to improve company's financial performance.**

2.3 Intangible Capital and Performance

Nofsingerand Weicheng (2011) found that behaviours actualized professionally in managing business can result in better company performance, so that the business success will be reflected from the business results. Miller *et al.* (2003) highlighted the importance of managerial and societal factors for business performance in small service and retail companies. This also supported the suggestion of Allen *et al.* (2012) that SME sector that grows rapidly in India is highly depend on the mechanism based on reputation, trust, and relationship to solve claims and disputes. This is consistent to the findings in enterprise levels in other areas across the world.**H3:Intangible Capitalsignificantly affects company's financial performance.**

2.4 Financing Decision and Performance

Bates (1997) suggested that small and medium company financing are mostly invested on human and financial capital, and a small amount in producing sales and profits. The realization of equity capital on company financing from the growth start until the high growth rate is the characteristic of the business. Colombo and Grilli (2005) stated that high quality entrepreneurs that have access to external equity financing start the operation from a level that are far higher than individuals with the same skills that are depend only to personal capital.**H4: Internal financing source significantly affects the company's financial performance; H5: external financing source significantly affects the financial performance.**

3. Method

Research population consisted of 56 of 3kgs LPG agents (Dinas Perindustrian Bali, 2011) and 50 managers or company owners had filled out questionnaire appropriately. Research variable measurement used Likert Scale with scoring interval ranged from 1 (strongly disagree) to 5 (strongly agree). Intangible variable of intangible capital consists of social and local culture capitals. The lowest score is 1, representing very weak social capital, and 5 as the highest score representing a very strong social capital. Similarly, the lowest score for local culture is 1, representing a bad culture, whereas 5 as the highest score representing very good culture. In detail, the score can be explained as following: 1-1.99 (very bad), score 2-2.99 (bad), score 3-3.99 (fairly good), score 4-4.99 (good) and score 5 (very good). For internal financing source variable, score 1 represents very low internal financing source, whereas 5 represents a very high internal financing source. In detail, the score can be explained as following: score 1-1.99 (very low), score 2-2.99 (low), score 3-3.99 (fairly high), score 4-4.99 (high), score 5 (very high). For external financing source variable, score 1 represents a very low external financing source, and 5 represents a very high external financing source. In detail, the score can be explained as following: score 1-1.99 (very low), score 2-2.99 (low), score 3-3.99 (fairly high), score 4-4.99 (high), score 5 (very high). For company performance variable, score 1 represents very bad company performance, and 5 represents a very good company performance. In detail, the score can be explained as following: score 1-1.99 (very bad), score 2-2.99 (bad), score 3-3.99 (fairly good), score 4-4.99 (good), score 5 (very good).To condunct hypotheses test in order to deliver a fit model, the research used Structural Equation Modeling (SEM) analysis supported by calculation of Partial Least Square (PLS) program, that is a SmartPLS software version 2.0 M3. PLS is a powerful analysis method since it does not need a particular data measurement to assume data. It also allows s small ammount of sample, and it can be use to confirm theories(Ghozali, 2011). Internal financing source discussed in this research is the decision of company financing in conducting all of its business activities, sourced from debt within the company. Internal financing source decision variable in this research measured by several items in form of relevant research instruments. It consisted of: (1) fund sourced from the owner; (2) fund sourced from ex-owner, that is from kerosene agent to 3kgs LPG agent; (3) fund sourced from owner's relatives; (4) fund sourced from inheritance (Bates(1997), Colombo and Grilli (2005), Denis (2004), Nofsinger and Weicheng (2011)). External financing source is financing decision of 3kgs LPG agent company to conduct all of its business activities sourced from outside the company. External financing variable measured using several items within instruments. It consisted of: (1) external financing sourced from friend's capital; (2) external financing sourced from banking capital; (3) external financing sourced from cooperation capital; (4) external financing sourced from venture capital; (5) external financing sourced from village credit institution (Beck, and Demirguc-Kunt (2006), Alen*et al.* (2012), Wu, Z *et al.*

(2007), Kosxan*et al*. (2011), Chua J.H *et al*. (2009), Tappeiner (2012), Mazzi (2012), Nofsinger and Weicheng (2011)). Intangible capital is a capital that can influence business activities measured using social and local culture capital variables. (Hofstade (1998), Brooks (2008)). Company's financial performance is the financial performance of 3kgs LPG agent measured with the company ability to achieve sales volume rate, as well as company asset (Chua J.H *et al*. (2009), Tappeiner *et al*. (2012), Mazzi (2012)).

4. **Results and Discussion**

4.1 Respondents' Characteristic

Most of 3kgs LPG agent entrepreneurs in Bali have a bachelor degree. They are approximately 60 percent. Followed by a high school degree for approximately 32 percent, junior high school degree for approximately 6 percent, and post-graduated for approximately 2 percent of the respondents. This relatively high-educated respondent is a special advantage for the company itself to be able to grow better . To improve business to higher level, one will need insights, as well as knowledge to improve skills so that they can deal with rapid technological change, such as communication technology via internet. Most of studied sample, approximately 86 percent, are at productive ages, ranged from 25 to 59 year old. Regarding this age range, there is an indication that they have high spirit, as well as high working time that will result in the probability to gain a relatively high-income rate. Age, in particular terms, can influence they performance in doing their business activity.In terms of 3kgs LPG agent company ownership, most of them were directly involved in the company management.

4.2 Hypotheses Test

The first hypothesis (H_1) that assumes that intangible capital (X) significantly affects the internal financing source/company capital (Y_1) of 3kgs LPG agents in Bali Province. Analyses result shows that path coefficient0.422 is strongly significant, with t count 6.154. By using level of significant α = 5 percent, then t count is higher than t table-critical1.96. the sign of path coefficient is positive, means that the better the intangible capital (X) reflected by social and cultural capital, the higher the probability to obtain financing to full fill company's financial needs sourced from own capital (Y_1). Second hypothesis (H_2) assumes that there is a significant effect of intangible capital towards external/debt financing decision on the company performance of 3kgs LPG agents in Bali Province. Analyses result shows that the value of path coefficient 0.419 has the magnitude of t count 2.862. By using level of significant α = 5 percent, then H_2 is acceptable, t count is higher than t table-critical 1.96. Thus, it can be statistically said that there are a positive and significant influence of intangible capital measured from social and cultural capital toward external financing source decision of 3kgs LPG agent companies in Bali Province. This positive sign can be means that the better the intangible capital of 3kgs LPG agent entrepreneur, the higher the probability to obtain financing sourced from outside the company (debt).The test of third hypothesis (H_3), it is presumed that the decision of internal financing source/own capital (Y_1) significantly influences the financial performance (Y_3) of 3kgs LPG agent in Bali Province. Analyses result shows that path coefficient 0.0443, with the magnitude of t count 0.326. At level of significant α = 5 percent, t count is smaller than t table-critical 1.96, then $H_3$is rejected, or H_0 is acceptable. This means that internal financing is not significantly influence company's financial performance of 3kgs LPG agents in Bali Province. This positive sign can be means that the higher the utilization of fund sourced from own capital, the higher the possibility that the financial performance cannot be improved. Forth hypothesis (H_4) presumes that there is a significant influence of external financing/debt source (Y_1) on financial performance (Y_3) of 3kgs LPG agents in Bali Province. Analyses result shows that the value of path coefficient0.290 with the magnitude of t count 2.749. At the level of significant α = 5 percent, t count is higher than t table-critical 1.96. thus, H_4 is acceptable. Therefore. The positive sign can be means that the higher the use of fund sourced from outside the company (debt), the higher the probability of improved company's financial performance. The test of fifth hypothesis (H_5), that intangible capital is positively and significantly influence company's financial performance of 3kgs LPG agents in Bali Province.

4.3 The Effect of Intangible Capital on Internal Financing Decision (Own Capital)

Intangible capital in this research is reflected by local culture and social capital. The better the culture and social capital, the higher the possibility of investor to invest their fund in the company. The result of this research is in line with previous researches such as: Anderson and Eshima, Y (2011) on the importance of intangible assets to encourage excellent SME growth. Tappeiner *et al*. (2012) stated that non-financial resources provided from personal equity improves the value of personal equity. Similarly, Gomez- Mejia *et al*. (2011)emphasized that non-economic factors have important role in managerial preference.

4.4 The Effect of Intangible Capital on External Financing (Debt)

Companies must maintain good behavior, as well as have to be honest and trusted by individuals or groups engaged in transaction. The higher level of trust given by the capital owner to invest their funds reflects a good intangible capital. Capital owner/investor will feel safe to invest their fund to a company if they find a good signal of honesty in the company. External financing in form of debt sourced from friends, banking, cooperation, venture capital, and village credit institution. These external financing sources consider that it is important to have intangible capital that can reflect a belief that the fund invested in the company will be safe. The result of this research supports Bosse (2009) that the involvement of family must improve the company ability to borrow family's social capital both directly and indirectly to solve agency problem with the lender. The result of this research also supports Nofsinger and Weicheng (2011), Bates (1997) that explained the presence of financing sourced from loan in studied companies that influence company's viability that use those external financing sources.

4.5 The Effect of Intangible Capital on Financial Performance

The result of this research indicates how importance is to pay attention to intangible capital in order to improve company's financial performance. High respect on rightness, honesty, hard work to achieve what is wanted, maintain togetherness within business environment, as well as respectful of other's work reflect a good culture that have to be maintained and promoted in the company. The result of this research support the research by Nofsinger and Weicheng (2011) that professionally actualized behavior in managing business can influence a better company performance, so that the business success will be reflected from the business result. The result of this research also supports the research by Miller *et al*. (2003) that highlighted the importance of managerial and societal factors for business performance in small service and retail companies.

4.6 The Effect of Own Capital on Financial Performance

Analyses result does not support the research hypotheses since own capital sourced from internal (family) cannot influence financial performance. Even though it is not significantly influences, the sign is positive. This positive sign means that the increasing use of funds sourced from inside the company (own capital) still cannot improve company's financial performance.

The result of this research supports the research by Colombo and Grilli (2005) that high-quality entrepreneur who gets access to external equity financing starts their operation from a bigger level than individual with similar skill who only relies on own capital. Thus, it can be said that 3kgs LPG agent companies, in order to improve their financial performance of their business activities, cannot only rely on limited internal financing source. This limited internal financing source shall be supported by external financing source to be able to improve the company's financial performance. The result of this research also supports the research by Bates (1997), stated that the financing of small and medium companies are mostly invested into human capital as well as financial capital, and invested at a very low level to deliver sales and profit. Realization of equity capital use to the company's financing from the beginning of growth to its high level is the characteristic of the business. However, the development of small and medium companies in terms of company's profitability experienced by Korean/Chinese migrant is low.

4.6 The Effect of External Financing Source (Debt) on Financial Performance

3kgs LPG agent companies use a relatively high level of external financing source to do their business activities.

This indicates that there are a higher responsibility if the company uses financing sourced from debt since it will faces higher risk than if it uses financing sourced from family. The presence of this higher responsibility can be reflected by a hard work to achieve higher sales rate. The reason expressed by these entrepreneurs can be interpreted as a high working spirit as a responsibility to achieve better financial performance, so that they still can be trusted by their creditors. Therefore, financial performance in terms of sales and assets progress is highly determined by the effort to fulfill financing sourced from debt. The result of this research supports the research by Colombo and Grilli (2005), stated that high-quality entrepreneurs who gets access to external equity financing start their operation from the higher level than individuals with similar skills who is rely only on their own capital.

5. Research Implications

A good intangible capital has an effect on company since it will be trusted by both internal and external lenders, so that they will keep investing their funds in the company. Good intangible capital also results in high company's financial performance. This result support previous research by Anderson and Eshima, Y (2011),Leary and Roberts (2010), Chua, J. H. *et al*. (2011), Bosse (2009),Wu, Z. *et al* (2007), and Myer (1984).

Research Limitation

The limitation of this research is the number of variable used to connect exogenous and endogenous variables since it includes Balinese culture and social capital indicators as intangible capital. Whereas examination conducted in other areas shall deliver different results. This research can be developed extensively by future researches by including the role of government and bank interest rates.

6. Conclusions

Good intangible capital can improve company's ability to look for internal financing source. Similarly, good social and cultural capitals are able to strengthen the company's ability to obtain financing sourced from its own capital. Good intangible capital is proofed to be able to improve company's ability to obtain external financing source in form of debt. The better the intangible capital reflected by good social and cultural capitals, the higher the success rate of 3kgs LPG agent companies to obtain financing sourced from outside the company in form of debt. The decision of internal financing (own capital) cannot improve company's sales and assets of 3kgs LPG agents in Bali Province.The decision of external financing (debt) can improve company's financial performance. This means that the higher the use of funds sourced from debt, the higher the ability to improve company's sales and assets of 3kgs LPG agents in Bali Province.Good intangible capital can improve company's financial performance. The better the company's social and cultural capitals, the higher its financial performance will become. Thus, by showing a good social and cultural capital, company's sales and assets of 3kgs LPG agents in Bali Province will increase.

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